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C O N F I D E N T I A L TOKYO 000904

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DEPT PASS USTR FOR AUSTRS CUTLER AND STRATFORD  
TREASURY FOR EAST ASIAN NATIONS - DOHNER AND KOEPKE  
TREASURY ALSO FOR INTERNATIONAL - LOEVINGER AND SOBEL  
COMMERCE FOR ITA DAS LEVINE AND OFFICE OF JAPAN - NMELCHER

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TAGS: [ECON](#) [EINV](#) [EFIN](#) [PGOV](#) [PREL](#) [JA](#) [CH](#)  
SUBJECT: JAPANESE BUSINESS SEEKS INDEPENDENT CHINA  
COMMUNICATION AND ANALYSIS

REF: A. TOKYO 822  
[1](#)B. TOKYO 831

Classified By: Ambassador J. Thomas Schieffer; Reason: 1.4 (B,D)

[1](#)1. (C) Summary: Confidence in the Japanese Government's capacity to analyze and to interpret events in China is waning among Japan's business community, according to some Japanese and expatriate Chinese researchers and academics. The anti-Japanese demonstrations of spring 2005 also alerted Japan's business leaders to a need for their own sources of analysis and channels of communication regarding China. Recent surveys of Japanese businesses undertaken by the Japanese Government indicate that a number of firms with China investments are looking to establish a presence in other Asian countries as a way to hedge against the possible political risk to their China operations. Though apparently not underway at this time, any substantial shift of economic interests away from China could reduce the business sector constituency in favor of steps to improve bilateral relations. End summary.

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Japanese Investors Gain New Awareness of "Original Sin"  
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[1](#)2. (SBU) According to C.H. Kwan (Guan Zhixiong), a researcher at Nomura Securities Institute of Capital Market Research, Japanese firms with operations in China had only recently become sensitized to what Kwan called their burden of "original sin" for Japan's past aggression against China. He noted that until the demonstrations in the spring of 2005, many Japanese in China had failed to grasp the depth of residual Chinese anger against Japan for the events of the Second World War. A number of Japanese firms, he indicated, have begun to finance "social projects" in China designed at winning over the general populace. (Note: The January 28 edition of the economic weekly Toyo Keizai carries a report listing a number of projects and

activities sponsored by over a dozen major Japanese companies like Toyota, Matsushita, and UFJ -- most prominently in education but also in other fields ranging from social welfare to environmental protection. End note.) Kwan added that the Ministry of Foreign Affairs had also explored the possibility of increasing cultural interaction with China as a way to improve bilateral relations but noted that the Foreign Ministry had been unable to gain political-level approval to finance its proposal.

13. (SBU) Kwan concluded that the investment data (ref B) did not yet reflect the change in sentiment and that a decline in Japanese investment flows to China would emerge before too long. Already Japanese companies were paying more attention to other promising developing economies such as Brazil, Russia, and India. Kwan cited a recent survey of Japanese firms with overseas operations by the Japan Bank for International Cooperation (JBIC), which indicates that positive sentiment on further investments in China was declining among the surveyed companies, to support his analysis. He also pointed to the 2005 Ministry of Economy, Trade, and Industry (METI) White Paper on International Trade and Investment, which stressed the importance for Japanese firms of diversifying the geographic risk in their investment portfolios. (Note: The JBIC Survey is available on-line in English at <http://www.jbic.go.jp/english/research/report/review/index.php>. Similarly, the METI 2005 White Paper is also available at: <http://www.meti.go.jp/english/report/index.html>. End note.)

14. (SBU) Kwan was fairly upbeat about the prospects for Japanese investment in China's financial sector. In particular, Chinese banks remained attractive to many Japanese investors because, first, the Chinese Government would not allow the banks to fail and second, the debt burden of the Chinese Government, though high, was still substantially less than Japan's, indicating the government had the resources needed to keep the banks solvent should a crisis arise. Although the current limits on foreign ownership of Chinese banks meant that the impact of foreign investment on the management of the banks would be relatively small in the near term, Kwan voiced confidence that those restrictions would decline over time, thus paving the way for improvements in corporate governance.

15. (SBU) For its part, Kwan's employer, Nomura, has seen mixed benefits from the beginning of a shift away from China by Japanese investors. On one hand, a Nomura-invested industrial estate in Vietnam that had lulled in the doldrums had suddenly picked up over the past year. On the other, the Garden Hotel in Shanghai, one of Nomura's premier investments in China, had fallen on relatively hard times. Nomura, which is already a "qualified financial institutional investor" (QFII) in China, is also looking to establish a joint-venture securities firm with a Chinese partner.

16. (SBU) Kwan said his Chinese contacts were also pessimistic about the future of Sino-Japanese relations. Statements by the leading ruling party contenders to replace Prime Minister Koizumi and recent comments by the leader of the Japanese opposition had led those Chinese observers to whom he had spoken to express the view that any significant change in the Japanese Government's attitude toward China was unlikely even in the event of a rise to power of the Democratic Party of Japan (DPJ) at some later point. Kwan's interlocutors believed that even if China and Japan achieved some resolution of their differences regarding the controversial Yasukuni Shrine, there would still remain too many potential areas of disagreement such as the dispute over development of oil and gas resources in the East China Sea and the possible amendment of Japan's current constitution to allow for a higher-profile Japanese military.

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## Industry Confidence in Government China Analysis Weakens

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17. (SBU) Toyogakuen University Professor Zhu Jianrong noted that the purging of the "China School" in the Ministries of Foreign Affairs and of Economy, Trade and Industry over the last two years had left relatively few officials with any substantial knowledge of China in positions with influence on Japan-China relations. In addition, he stressed that a longstanding flaw of Japanese official China analysis was the tendency to overspecialize; officials in the Japanese diplomatic mission in China tended to be technical experts who produced very detailed and well researched reports on specific issues but who often failed to make the connections to larger Chinese strategies or trends, thus missing the "big picture."

18. (SBU) According to Zhu, Japan's business community had realized these failings on the part of the government and has established its own China-watching infrastructure. This expertise, often embodied in expatriate Chinese living in Japan, is located in individual companies but not in the broader business associations like the Japan Federation of Business ("Keidanren"). Zhu added that expatriate scholars like himself were also part of that infrastructure. He showed econoff a list of members of a "study group" (benkyokai) on China including the names of the heads of several dozen of Japan's major corporations (Toyota, Toshiba, Matsushita, etc.) that had been organized by the Nihon Keizai Shinbun Corporation. The lecturers for this group were exclusively expatriate Chinese academics. Zhu cited as an example of the topics covered the new strategy for urbanization announced in the Chinese Communist Party Central Committee's "Proposal" for the 11th Five Year Plan.

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## Political Frictions Could Impede Needed Economic Dialogue

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19. (SBU) The chief threat to the China-Japan economic relationship from deteriorating political ties is the potential for a breakdown of needed government-to-government communication, according to Kazuko Inoue, a researcher at the Mitsui Global Strategic Studies Institute (MGSSI). (Note: MGSSI is the in-house think tank of the Mitsui Corporation. End note.) Inoue stressed that, although there were no critical issues in the economic relationship at the moment that needed political-level government intervention, should such an issue emerge, the ongoing political friction could impede the capacity of both countries to handle the situation. In Inoue's view, the Chinese leadership has been looking for ways to improve the relationship with Japan but lacked a concrete method for doing so. In addition, the popular sentiment in China toward Japan had become more difficult for the authorities to control, thus complicating their efforts to manage economic relations.

110. (SBU) Characterizing Prime Minister Koizumi's stated rationale for repeatedly visiting the Yasukuni Shrine as "twisted," MGSSI Chairman Jitsuro Terashima was more sharply critical of Japan's leaders for the downturn in relations with China and Korea, and he suggested this situation had damaged Japan's standing among Asian countries as a whole. Koizumi's foreign policy, Terashima said, had overemphasized the relationship with the United States to the detriment of Japan's potential role as a "bridge" to East Asia. Terashima floated the idea of cooperation on economic topics among China, South Korea, and Japan -- for example, promotion of economic development in Southeast Asia through the Asian Development Bank or joint measures to preserve financial stability in the region like the Chiang Mai Initiative -- as a way potentially to begin to rebuild trust among the three countries. According to Terashima, certain members of the Japanese leadership stratum -- notably former Chief Cabinet Secretary Yasuo Fukuda -- held views similar to his own on the need to

improve relations with China and Korea.

¶11. (C) Keidanren Chairman Hiroshi Okuda echoed Terashima's criticism in a February 15 lunch with the Ambassador. Asked about the qualities most needed in a successor to Prime Minister Koizumi, Okuda unhesitatingly replied that the capacity to manage relations with China and Korea would be the most critical skill required in a new Premier. Okuda also indicated that, in his view, the leading candidates to succeed Koizumi were noticeably lacking in this regard.

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¶12. (C) Although our contacts expressed varying degrees of concern about the possible effect of the current "cold" political climate between Japan and China, they were generally in agreement on the point that the Japanese political leadership does not view improving relations with China as a priority. As a result, major Japanese corporations and business leaders have increasingly begun to look for their own alternative channels to the official relationship to secure and to further their interests in China. The anti-Japanese demonstrations of the spring of 2005 obviously added a sense of urgency to this effort. Adding a new consideration of political risk to existing worries over possible "overheating" in the Chinese economy, the demonstrations also appear to have accelerated a trend among Japanese firms to hedge their China operations by establishing a complementary presence in another nearby Asian country such as Vietnam (the so-called "China plus one" strategy). Insofar as this phenomenon does not seem to be leading to a diminution of the overall Japanese presence in China, it is probably both a sound business strategy and a good reminder to the Chinese authorities of their economic vulnerability should political frictions get out of hand. At the same time, however, should Japan's business community substantially shift its interests away from China, it could weaken the influence of those in Japan looking to find a way to ease the present political tensions.  
SCHIEFFER